IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 420

GIBRALTOR AMUSEMENTS, LTD., *Petitioner*,

v.

THE WURLITZER COMPANY AND WURLITZER ACCEPTANCE CORPORATION, *Respondents*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on May 24, 1961.

CITATION TO OPINIONS BELOW

The opinion of the Court of Appeals rendered on May 24, 1961, is reported at 291 F. 2d 22 and is reprinted as Appendix A hereto. The opinion of the District Court for the Eastern District of New York

(Bartels, J.) is reported at 187 F. Supp. 931 and is reprinted as Appendix B hereto.

JURISDICTION

The judgment of the Court of Appeals was entered on May 24, 1961. On August 16, 1961, Mr. Justice Frankfurter signed an order extending the time for filing this petition for writ of certiorari to and including September 21, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether, under Section 59(b) of the Bankruptcy Act, a petitioning creditor's wholly owned subsidiary, to which the parent creditor has assigned certain claims against the debtor prior to the filing of the bankruptcy petition, can be counted as one of the three petitioning creditors essential to the maintenance of an involuntary petition in bankruptcy.

STATUTE INVOLVED

Section 59(b) of the Bankruptcy Act, 11 U.S.C.A. § 95(b), entitled "Who may file and dismiss petitions", reads as follows:

"Three or more creditors who have provable claims liquidated as to amount and not contingent as to liability against any person which amount in the aggregate in excess of the value of securities held by them, if any, to $500 or over, or, if all of the creditors of such person are less than twelve in number, then one or more of such creditors whose claim or claims equal such amount, may file a petition to have him adjudged a bankrupt."

STATEMENT OF THE CASE

The petitioner, Gibraltor Amusements, Ltd., is the alleged bankrupt in this proceeding.

On March 18, 1960, an involuntary petition in bankruptcy was filed by the respondent Wurlitzer Company as a sole creditor, alleging less than twelve creditors of the bankrupt.[1] The bankrupt filed an answer on March 29, 1960, denying *inter alia* that there were less than twelve creditors. An amended involuntary petition was then filed by the Wurlitzer Company on May 5, 1960, again alleging less than twelve creditors. Thereupon one William F. Wadsworth and the Wurlitzer Acceptance Corporation (WAC) were granted leave to intervene and join as petitioning creditors. The amended answer, filed on May 10, 1960, reiterated the denial of the allegation as to twelve creditors and asserted (R. 19a) that "Wurlitzer Acceptance Corporation, an intervening creditor, is a wholly owned subsidiary of the petitioning creditor and as such does not qualify as an independent, separate petitioning creditor."

The matter was then referred to a Referee in Bankruptcy. The trial before the Referee was narrowed by concessions to the sole issue "of whether a sufficient number of qualified creditors have joined in the petition for involuntary bankruptcy, at least three qualified creditors being required as the record disclosed that the alleged bankrupt had twelve creditors or more on March 18, 1960." R. 21a.

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[1] R. 2a. The record references herein are to Volume 1 of the certified record, consisting of the appendix to petitioner's brief in the Court of Appeals.

The Referee, upon the conclusion of the trial, made the following pertinent findings and conclusions:

(1) WAC, the intervening creditor, is a Delaware corporation and a wholly owned subsidiary of Wurlitzer. R. 23a. "It was organized in 1957 for the primary purpose of financing sales of Wurlitzer products. It finances all sales generated by the retail music stores owned and operated by the parent company, as well as sales made by Wurlitzer dealers, distributors and operators. It is a distinct legal entity separate and apart from its parent corporation. It acquired the notes and security long prior to the bankruptcy." R. 23a.

(2) More than $1,000,000 was owed by the bankrupt to Wurlitzer, the indebtedness being in the form of defaulted promissory notes secured by conditional sales contracts. Wurlitzer had acquired these notes and contracts as a holder in due course and they constituted valid and subsisting liens against the bankrupt and its property. R. 22a.

(3) Two of the aforesaid promissory notes had been acquired by WAC in the regular course of its business by assignment from Wurlitzer. One note had been so acquired on October 31, 1958, and the other on May 28, 1958; on the date of filing the bankruptcy petition (March 18, 1960) these notes were in default in the respective amounts of $5,261 and $4,785. R. 24a. On May 15, 1959, the bankrupt had executed and delivered a written guaranty of payment to Wurlitzer of certain obligations, including the notes in question. The Referee concluded that this guaranty "expressly extended not only to Wurlitzer but to its 'successors and assigns' and thus included WAC" and that upon the assignment of the two notes to WAC the latter "became entitled to the benefit of the alleged bankrupt's guaranty." R. 24a-25a.

(4) Finding that the assignment by Wurlitzer to WAC of the two notes without recourse "was sufficient to transfer title to WAC" and give the latter a right of action against the bankrupt, the Referee concluded that "WAC is a creditor of the alleged bankrupt, and in every respect qualified to act as a petitioning creditor herein." R. 25a.

The Referee, having found that Wurlitzer, WAC and two individuals qualified as petitioning creditors and that the total number of creditors was more than twelve, held that the petitioning creditors were entitled to an order adjudging the petitioner herein to be a bankrupt. R. 28a. An order to that effect was duly entered. R. 29a-30a.

Upon a petition for review filed by the bankrupt, the District Court affirmed the order adjudging petitioner a bankrupt, except that it overruled the Referee's finding and conclusion that one of the individuals qualified as a petitioning creditor. R. 34a-43a. As a result, the bankruptcy adjudication was sustained on a finding that there were three qualified petitioning creditors—the minimum number required to sustain an involuntary petition in these circumstances. As to the petitioner's objections to counting WAC as one of those three, the District Court ruled that WAC was qualified as a separate entity, there being no proof that the parent Wurlitzer Company had employed WAC for an illegal purpose or as a front so as to justify piercing WAC's corporate veil. R. 39a-40a.

The Court of Appeals affirmed by a two-to-one vote, Judge Friendly dissenting. The majority held that WAC should be counted as an independent petitioning creditor in the absence of any showing that Wurlitzer had in some way used WAC to subvert the Bank-

ruptcy Act. Judge Friendly wrote that it was contrary to the history and purpose of the Act to regard a parent and a subsidiary as separate entities in counting the requisite number of petitioning creditors in involuntary proceedings, even in the absence of any proof of fraud or intent to subvert the Act.

REASONS FOR GRANTING THE WRIT

The decision below raises an important, unresolved and recurring problem in the administration of the Bankruptcy Act that needs definitive resolution by this Court.

Under Section 59(b) of the Bankruptcy Act, 11 U.S.C.A. § 95(b), where there are more than twelve creditors of the debtor, "it is indispensable to the maintenance of the [involuntary] petition that the existence of three petitioners holding provable claims be established, if challenged." *Canute Steamship Co.* v. *Pittsburgh & West Virginia Coal Co.*, 263 U.S. 244, 248. And see *Meek* v. *Centre County Banking Co.*, 268 U.S. 426, 431, note 3. The problem here is whether a wholly owned subsidiary of a petitioning creditor can be counted as one of the three necessary petitioners on the basis of its purchase of certain claims against the debtor from its parent corporation.

The majority of the Court sought to answer that question affirmatively by relying upon the proof in this case that WAC, the wholly owned subsidiary, is an entity separate and distinct from its parent Wurlitzer Company and upon the complete absence of any indication that Wurlitzer had abused or disregarded WAC's independence. In the absence of some showing of a fraudulent subversion of the "rule of three" provision of the Bankruptcy Act, said the court, WAC's status as a petitioning creditor must be honored.

But the basic question remains whether, if it be assumed that WAC was independent of Wurlitzer and acquired the claims from Wurlitzer in the normal course of its legitimate business, such related enterprises can be counted as two separate petitioning creditors for purposes of Section 59(b) of the Bankruptcy Act. And the answer to that critical problem is not to be found in the general provisions of contract or tort law giving recognition to the independent status of such parents and subsidiaries. See *Owl Fumigating Corp.* v. *California Cyanide Co.*, 30 F. 2d 812, 813 (C.A. 3). Nor is it to be found in decisions refusing to pierce the corporate distinctions of such related organizations in other statutory contexts. And by the same token, disregarding the corporate distinctions in any setting other than Section 59(b) of the Bankruptcy Act brings no solution to this problem. As stated in *Scheuley Distillers Corp.* v. *United States*, 326 U.S. 432, 437: "While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and *where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person.*" [Emphasis added.][2]

The essence of the problem thus is whether treating a wholly owned independent subsidiary, that has purchased a debt from its parent, as a creditor separate from its parent creditor corporation does violence to

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[2] Some of the relevant considerations in determining whether separate entities constitute one economic enterprise are listed in *Labor Board* v. *Deena Artware, Inc.*, 361 U.S. 398, 402-404. See also *Chicago, M. & St. P. R. Co.* v. *Minneapolis Assoc.*, 247 U.S. 490, 501.

the legislative purpose expressed in Section 59(b) of the Bankruptcy Act. The majority below merely said that if Congress meant Section 59(b) to alter the ordinary judicial rules recognizing the separate status of wholly owned subsidiaries "it should have so provided specifically." But the presence or absence of specific words may not be the solution to this type of statutory problem, particularly since the legislative words here permit conflicting interpretations. See *Burnet* v. *Guggenheim*, 288 U.S. 280, 285.

The answer may well lie in Judge Friendly's analysis of the Congressional background of Section 59(b), an analysis showing that this provision represented a compromise "between those who wanted to give the creditor an effective remedy to assure equal distribution of a bankrupt's assets and those who were determined to protect the debtor from the harassment of ill-considered or oppressive involuntary petitions, including those by a single creditor interest." On the basis of his examination of the legislative record, Judge Friendly concluded that the thrust of Section 59(b), as a compromise of opposing forces, was "to require three separate creditor interests, separate in reality and not merely in form."

The issue is thus squarely joined in this case. On the record there has been found no indication that WAC was other than an independently operated subsidiary or that it acquired its claims other than in the normal course of its legitimate business. But neither is there any question as to its being wholly owned by Wurlitzer or as to its having acquired its creditor status solely by purchase of debt claims from Wurlitzer. These may be separate legal entities but there is in fact but one creditor interest. And the problem

is inescapably raised in its purest form—whether Congress meant to require three creditor entities or three separate creditor interests.

If the majority's view be adopted, anomolous results could follow. As Judge Friendly pointed out, a single creditor corporation, for good business reasons, could parcel out some of its debt claims to two or more financing subsidiaries and thus insure its ability to initiate an involuntary bankruptcy proceeding should there be more than twelve creditors. By so doing, the creditor corporation would in effect be creating three creditors where originally there was only one. A single creditor interest could thus become dominant even in the absence of any intent to subvert the "rule of three." And the statutory policy of protecting the possible desire of the twelve or more other creditor interests (especially those having no preferences) to have the business continue free of bankruptcy proceedings becomes subordinated to the wishes of this single creditor interest. The "rule of three" could accordingly become meaningless.

The concentration of power thus placed in the hands of a parent corporation that disposes of some of its debt claims to its subsidiaries—or even to unaffiliated corporations—raises an increasingly important problem in the administration of the Bankruptcy Act. As the creation and use of wholly owned financing subsidiaries become more prevalent in the United States, precisely the kind of problem posed by this case will become more frequent in bankruptcy proceedings. The court below, perhaps the most experienced tribunal in the country in bankruptcy matters, has been unable to provide a clear-cut solution. So significant a problem thus deserves the plenary consideration that only this Court can give to it.

Certainly this issue is no less significant for certiorari purposes than the question which led to the grant of certiorari in *Canute Steamship Co.* v. *Pittsburgh & West Virginia Coal Co.*, 263 U.S. 244, the question there being whether subsequent intervening creditors could be counted in determining whether, under Section 59 (b), there was compliance with the "rule of three."

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

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